MOLECULAR DIAGNOSTICS

MOLECULAR DIAGNOSTICS M&A: DORMANT BUT NOT DONE

Recent reports suggesting that venture investment in molecular diagnostics is down and that overall deal activity is depressed as well may have rattled investors. But this topline assessment of the industry overlooks the underlying trends at play, especially the need to integrate recent acquisitions – many of which were by new buyers demanding different needs and outcomes from their technology acquisitions – before the next shopping spree. The current crop of companies must mature prior to the commencement of additional M&A activity. Historical data suggest this could occur starting in the 2014-2015 timeframe.

It used to be that molecular diagnostics tools companies had only limited funding sources and exits. A relatively small number of VCs invested, with the intent that funded companies would land in the hands of a life science or clinical diagnostics powerhouse such as **Beckman Coulter Inc.** (now a division of **Danaher Corp.**) or **Thermo Fisher Scientific Inc.**, or a diversified lab like **Quest Diagnostics Inc.** But that has changed in the last several years as service providers, life science tools companies, and even pharmaceutical companies entered the space. (*See "What's Fueling The Recent Diagnostics Dealmaking?"* — IN VIVO, *April 2011*.)

A new group of buyers are all competing for assets with demonstrated clinical value. The acquisition of Genoptix, Inc. by **Novartis AG**, **BlueGnome Ltd.** by **Illumina Inc.**, and **Gen-Probe Inc.** by **Hologic, Inc.** readily signal this shift in market dynamics. The pool of buyers is changing and so are their needs. Take **Life Technologies Corporation**, an historically focused life sciences company. Its two recent deals, for personal genomics specialist **Navigenics, Inc.** and the lung cancer test developer **Pinpoint Genomics Inc.**, gave Life Tech CLIA lab capabilities and put it squarely on track to enter the clinical diagnostics business. This is a departure from Life Tech's traditional area of focus and required it to look outside its usual acquisition map toward clinic-ready technologies and services as opposed to generalizable technology platforms – a noteworthy trend for many nontraditional buyers in the last two years (*see Exhibit 1*).

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Deal activity has been limited not only by the demand generated by buyers but also the supply of quality assets. Thus, looking at the average gestation period from founding to exit should enlighten the understanding of the timing of the next round of deal activity. Data from Elsevier Business Intelligence's *Strategic Transactions* identified 81 exits with reported deal values from 1H2009-1H2012. Looking at a representative subset of these deals (15), with deal values ranging from $80-$340 million, the average gestation time from company founding to acquisition was about 11 years. This implies that to understand the deal landscape today, one should look to companies founded in 2001.

The early 2000s were a period of economic uncertainty and low VC investment. Biotech VC funding, which had risen to about $4 billion in 2000, dipped nearly 20% the following year and was depressed the next several years, according to data from the National Venture Capital As-

Exhibit 1

Nontraditional Buyers Entering The Molecular Diagnostics Market

Acquirer	Target	Comments
Novartis AG	Genoptix, Inc.	Traditional pharmaceutical company brings reference lab and diagnostic capabilities in-house
Life Technologies Corporation	Navigenics, Inc.	Life science tools company acquires CLIA lab and technology infrastructure
Life Technologies Corporation	Pinpoint Genomics, Inc.	Life science tools company acquires CLIA lab and clinical diagnostic
PerkinElmer Inc.	Signature Genomic Laboratories LLC	Life science tools company acquires genetic testing company
GE Healthcare	Clarient, Inc.	Diversified MedTech company purchases oncology CLIA lab
Nestlé Health Science SA	Prometheus Laboratories Inc.	Food and beverage company purchases GI-focused therapeutics and diagnostics company
Agilent Technologies, Inc.	Dako AS	Life science tools company acquires leading anatomical pathology company

Source: Elsevier's *Strategic Transactions* sociation Sourcebook. Medical device VC investing similarly fell nearly 15% between 2000 and 2001, and slid below its $2 billion peak in 2000. (The decrease in VC investing early in the 2000s is reflected in today's M&A deal landscape, with current molecular diagnostics deals down over 10% from the peak of activity in 2010.)

By 2004-2005, however, a positive sustained trend in VC funding became evident. Biotech investing soared to more than $5 billion in 2007 and device investing topped $3.5 billion.

Using the 11-year rule, this would imply that the next bolus of mature and attractive companies will begin to materialize in 2014-2015, with additional companies primed for M&A toward the end of the decade.

In sum, changing market dynamics, recent acquisitions, a changing buyer pool, and long company gestation periods come together to explain – and counter – the more negative picture of the industry's health. This more optimistic view is shared by Jonathan Norris, managing director at SVB Capital, who recently authored a report detailing recent exits by VC-backed life science firms. Norris notes that 2011 was a seven-year high for number and value of exits. So, while overall macroeconomics are challenging, a changing approach to technology development is heralding a new normal, where companies look to partner early and their exits are only limited by how wide they cast the net.

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